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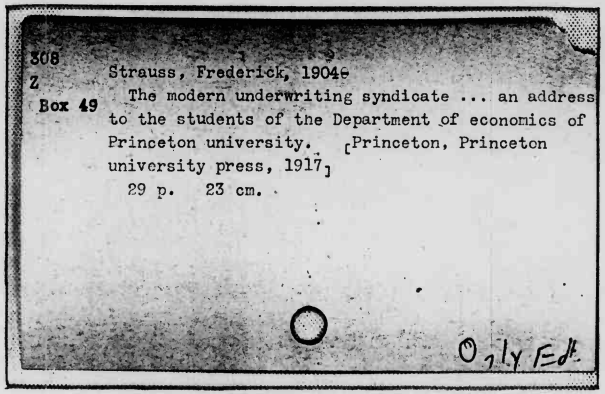
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Prof. E. R. A. Seligman

# THE MODERN UNDERWRITING SYNDICATE

BY

FREDERICK STRAUSS
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AN ADDRESS TO THE STUDENTS OF THE
DEPARTMENT OF ECONOMICS OF
PRINCETON UNIVERSITY

Published April, 1917

# THE MODERN UNDERWRITING SYNDICATE

In his "Instances in Modern Philosophic Thought," Dr. Hadley says that a man's philosophy is the result of his endeavor to harmonize his experiences with his prejudices and in the same interesting book he points out that so far as any philosophy meets the needs of its own time, it is good, and so far as it fails to satisfy the wants of the next generation, it is bad.

William James, in his "Pragmatism," speaks of "truth's cash value," saying that when a "truth becomes relevant to one of our emergencies, it passes from cold storage to do work in the world and our belief in it grows active. You can say of it then either that it is useful because it is true or that it is true because it is useful. Both these phrases mean exactly the same thing, namely, that here is an idea that gets fulfilled and can be verified." And again he says, "men's beliefs at any time are so much experience funded. But the beliefs are themselves part of the world's experience and become matter, therefore, for the next day's funding operations."

Lord Bacon thus begins his "Essay on Truth." "'What is truth?' asked jesting Pilate, and would not stay for an answer." He evidently knew no satisfactory answer would be forthcoming.

When Pope said "whatever is, is right" he meant that whatever exists and persists has a certain validity in the world's experience, and remains right provisionally or has, as James puts it, "become matter for the next day's funding operations," that is to say,

it has a certain "cash value," at least until that cash value shrinks and disappears.

While Goethe, in his "Reflections and Maxims," seems to contradict Pope's statement when he says that "as error ever persists in action we must therefore indefatigably utter truth in speech," yet under this seeming contradiction we find expression of this same idea, namely, that what exists, although imperfect and capable therefore of improvement, yet serves the needs of the hour, but only of the hour, and requires the constant utterance of truth, itself constantly changing from hour to hour and generation to generation, in order that present actions may more nearly conform to the needs of the hours and the generations to come.

In speaking to you this afternoon on the "Modern Underwriting Syndicate" I shall seek the shelter that these philosophers, economists and poets afford, and shall insist that the continued existence of that useful though reprobated institution is, in a measure, proof of the validity of that existence. The mere fact that it has lived so long and still lives with undiminished vitality shows that it has served, and still serves, and that it has a "cash value" in truth, as well as in the markets of the world.

I shall try to explain the uses and some of the operating methods of the underwriting syndicate, and to justify to you those uses, at the same time trying to clear away some misconceptions.

Some years ago, when the public was indulging in one of its periodical attacks upon wealth engaged in developing the country's resources, a witty person defined a syndicate as "an aggregation of individuals, firms and corporations formed for the purposes of underwriting and overreaching," and before that time



and since, the word "syndicate" has in the public mind been associated with nefarious plans of one sort or another. As a matter of fact, a syndicate is in essence merely an aggregation of individuals, firms and corporations associated together for a definite, limited purpose, and is usually of very short duration. Were it not that syndicate operations generally require quick decisions involving large amounts and hence requiring broad powers to the syndicate managers, the objects sought to be achieved by a syndicate could probably be achieved equally well by a limited liability company. The latter device, besides being much more cumbersome, would also be much more expensive, involving large incorporation and other taxes, fees and outlays. Whatever may be the *legal* difference, in *practice* the differences between a syndicate and a limited liability corporation are essentially the points I have just indicated, namely, the former is of short, the other of practically unlimited duration—the former is for a single ephemeral purpose, the other for numerous and continuing purposes,—the former is perforce carried on by syndicate managers with broad, almost absolute, powers, but with little legal responsibility attaching to the managers—except for wilful misconduct,—the other by officers and a board of directors with circumscribed powers and strict legal liability for acts performed by them.

The broad powers accorded to syndicate managers are rarely, if ever, abused. I cannot in my experience at this time recall a single instance of such abuse. Many mistakes have been made and many syndicate losses incurred, but suits by syndicate participants growing out of such mistakes and losses have been so rare as to be negligible. Giving uncontrolled power to the syndicate managers has caused them to feel all

the more their responsibility to the syndicate, and to recognize that the slightest suspicion of abuse of the powers granted would make it difficult, another time, for them to form a syndicate. So self-interest has worked hand in hand with the spirit of fair dealing, in establishing syndicate management upon a high plane. For the same reason it is rare that a syndicate participant intentionally violates the provisions of a syndicate agreement. Any one guilty of such violation would thereafter be excluded from participation in syndicates formed by the same managers, and as such violation would soon become known, other managers would be chary of including him in theirs.

The public mind has become accustomed, at least to some extent, to the corporation, but it has still to learn that a syndicate is not so essentially different from a corporation. Its life is of short duration, so also is its power, for when the object for which it was formed has been accomplished or has failed of accomplishment, its existence automatically terminates. It is true that a syndicate agreement delegates greater powers to the syndicate managers than are enjoyed by officers of a corporation, but upon realizing that syndicate managers (frequently one firm but sometimes two or three firms) merely form a financial group to carry through a transaction beyond the financial means of the firm or firms that are acting as syndicate managers, or because these are unwilling to risk so large a part of their means in one particular venture, it will become apparent that a syndicate is really not so very different from a firm consisting of a number of partners, in the hands of one of whom the others have placed the necessary powers to carry through a particular transaction. A firm, when successful, continues indefinitely from year to year and from generation to generation, and the life of a corporation is practically perpetual. A syndicate, however, usually terminates in one, or two or more months, and rarely continues beyond a year, although there have been cases where syndicates have extended over five years. The more disturbed the times are, the shorter is the syndicate's life, for men are loth to bind themselves for considerable amounts over a long period of time, when they know not what the morrow may have in store for them.



I shall now try to explain to you the different kinds of syndicates, how they are formed and how operated, and I shall also speak of the relation of syndicate profits to risks, for not infrequently instead of profits there are losses, though in the public imagination the word "syndicate" is invariably connected with profit and usually with rapacity as well. I shall also make some general observations about certain matters directly or indirectly connected with syndicates and syndicate operations.

A syndicate, as I have already said, is after all nothing more than aggregation of firms, individuals and corporations united under the leadership of one or more firms, called the syndicate managers, for the purpose of enabling these syndicate managers to carry through a certain definite financial operation, the nature of which is disclosed to the participants and is almost always a matter of public knowledge, and the carrying out of which is left solely in the hands of the syndicate managers, with full powers granted them for the purpose. Sometimes when it is a case of a simple purchase and resale of securities of some existing issue, the prospective syndicate managers obligate themselves in advance of forming the syndi-

cate, to buy from the corporation the securities it has for sale, and immediately after making the purchase, form the syndicate, in order to divide the risk. Usually, however, matters are not so simple and involve a financial plan that is devised and developed by the syndicate managers. When such a plan is ready for execution, and not until then, the syndicate managers send out what are termed "syndicate letters" to firms, individuals and institutions with whom they have had satisfactory business relations in the past, or with whom they desire to cultivate future business relations, or to those that may have heard rumors of the probable formation of the syndicate, and have accordingly applied to the syndicate managers for a participation therein, inviting them to participate in the proposed business. In sending out "syndicate letters" the managers adopt one of two courses. Either they ask to what extent participation is desired, and on learning the amount desired, allot such proportion thereof as circumstances may permit, or else they offer a definite amount, requesting an early answer whether or not the participation is accepted. When the former course is adopted participants not infrequently receive less than the amount applied for. Especially is this the case where the firm or firms acting as syndicate managers have the reputation for success, for here the demand for participation is great, and usually exceeds the amount available for allotment. This course, therefore, usually results in some disappointment to applicants, insofar as large participations may have been applied for and only comparatively small amounts thereof allotted. The participant, in that case, consoles himself by reflecting that it is better to have a smaller participation in a syndicate that is much sought after,



than a large participation in one that is not. Where the second course is pursued, namely, that of an offer by the syndicate managers of a definite participation, the "syndicate letters," in cases where the amount of participation offered is small, frequently state the regret of the managers at their inability to offer more, because the sum to be raised is in itself a comparatively small amount or else because advance applications have been received to such an amount as to render it impossible to offer larger participations. Participants in such cases also frequently express dissatisfaction with the amount of their allotments, but, as in the case just cited, they find satisfaction in the thought that their own judgment is confirmed by that of others, and that the great demand for participation holds out the promise of a profitable outcome.

On the other hand, when allotments are made in full, or offered in too large an amount, a feeling of apprehension arises in the minds of participants that such generous treatment may be an indication that in the judgment of others, the syndicate is not likely to prove a great success. Such is human nature, in Wall Street, as elsewhere in the world.

Perhaps now is as good a time as any to say a word about the etymology or meaning of the words "syndicate," "underwriting" and "subscription." My own definition of the term syndicate as in use today, I have already given you. The dictionary defines a syndicate as a "combination," and says that it is derived from the Mediaeval Latin "syndicatus," meaning "an examination of public morals." If the term "syndicate" had that meaning a thousand years ago, it is indeed translated into something very different today. Far from being today an examiner or censor of public morals, the syndicate has itself become the object of

censorious examination in the interest of public morals, and "thus the whirligig of time brings in its revenges." The word "underwriting" etymologically has the same meaning as the word "subscription," which latter is derived from the Latin *"sub,"* meaning "under," and "scribere," "to write." A man *"sub*scribes" or *"under*writes" when he writes his name *under* something that has gone before. The dictionary also defines the words as synonymous, thus, "subscription" is "anything underwritten"; "a formal agreement to make payment"; "something to which one has bound one's self by writing one's name beneath"; and conversely "underwriting" is defined as "subscribing"; "agreeing to pay by subscribing one's name." In spite, however, of this identity in etymological and dictionary meaning, and in spite also of the interchangeable use of these words in common business parlance, nevertheless there is a technical distinction between these words when applied to syndicates, growing out of the original application of the word "underwriting," more particularly to insurance. By "underwriting a policy of insurance" the underwriters held themselves liable, in the event of the happening of certain things, to make certain payments, and today the word "underwriting" is associated in everybody's mind with insurance in its various forms.

Before the formation of insurance companies, a number of merchants would get together and guarantee each other against loss of their cargoes by reason of marine risks. The shipping merchants of London met at "Lloyd's Coffee House" and there they would "underwrite" each other's maritime ventures, agreeing, in the event of the loss of any particular cargo, to make good the loss to the insured



in proportion to the amounts set opposite their names in the "policy of insurance," as it was termed. For this service the underwriters received proportionately, in accordance with the risk run, a certain percentage of the value of the ship or of the cargo. It was not till 1871 that "Lloyd's" became incorporated. The meaning of the term "Lloyd" has since been broadened to cover shipping associations generally, and such names as "North German Lloyd" or "Austrian Lloyd" as applied to steamship companies, or "Lloyd's Register," the association that rates vessels according to tonnage and qualifications, are well known to us. They are directly derived from "Lloyd's Coffee House" just referred to.

As the limited liability corporation is a comparatively modern invention, insurance companies as we now know them did not exist in the early days of insurance. They were a later development, growing out of the necessities of the shipping merchants, thus exemplifying that "cash value" of which William James speaks, and which I quoted in an earlier passage.

In Shakespeare's time there was no such thing as modern insurance, let alone insurance companies, and Antonio, in "The Merchant of Venice," with "an argosy bound to Tripolis, another to the Indies," "a third at Mexico and a fourth for England," was nearly ruined when these and "the other ventures he hath squandered abroad" were all reported wrecked. If Antonio had lived some hundred years later, his losses would have fallen upon the "underwriters."

The use of the term "underwriting" was subsequently extended from the guaranty of losses growing out of maritime ventures, into other business activities, and when used in its narrower technical

meaning, in connection with the term syndicate, it is usually applied to the guaranty by a syndicate, of the performance by someone other than the syndicate members, of certain financial operations, or else to the guaranty of a risk that someone else is expected to take, and which only in the event of an unfavorable and unexpected outcome is to fall upon the underwriters.

An example of such an "underwriting syndicate" is the undertaking by a syndicate to purchase from a corporation whatever stock may not be bought by its own shareholders, on an offering, by the corporation, of its stock to its own shareholders. For this service the syndicate gets a commission, and any stock not so purchased by the shareholders is either marketed for account of the syndicate by the managers, or, if this is impossible of accomplishment, it is distributed to, and paid for by, the underwriters, who dispose of it in their own way or who continue to hold it until a market is established.

"Underwriting syndicates," confining the term to its strict and narrow meaning, are formed chiefly where corporations desire to be assured of the proceeds of sale of stock or convertible bonds, offered for subscription to their shareholders. The right of the shareholders to subscribe to such stock or convertible bonds is evidenced by subscription warrants, which, when the stock has a market value in excess of the offering price, command a premium in the market, and are known colloquially as "rights." Bonds or notes (other than convertible bonds or convertible notes, i. e., bonds or notes that may at the holder's option, on certain terms, be converted into stock) are rarely, if ever, offered as "rights" to stockholders, and are not therefore handled by an "underwriting syndicate." In some cases, but not frequently, *convertible bonds* or *convertible notes* are not offered by the corporation to its own shareholders for subscription, and occasionally, though very rarely, even *stock* is not so offered. In such cases the services of a "purchase" or "subscription syndicate" are availed of, instead of those of an "underwriting syndicate," so-called. While there is a technical difference between an "underwriting syndicate" and other syndicates, in general parlance, "underwriting syndicate" is used quite indiscriminately to cover not only "underwriting syndicates," strictly speaking, but also all other kinds of syndicates. I have therefore made no change in the title of this address, but have left it as Dr. Kemmerer termed it in asking me to address you, although my talk is meant to cover all sorts of syndicates, and not merely the underwriting syndicate in its narrow sense.



You will find all through financial nomenclature the same sort of looseness in the use of terms. Sometimes a word is used with strict accuracy as to meaning, and then again it is used loosely, and yet, curiously enough, those active in financial circles understand each other without difficulty. So with the words "subscription syndicate." Strictly speaking, a "subscription syndicate" is one whose members unite to subscribe for an issue of securities, irrespective of whether the securities, once acquired, are disposed of, for syndicate account, by the syndicate managers, which is the usual method, or whether each subscriber is left free to dispose of his proportion of the securities acquired which method is rarely adopted. The "subscription syndicate" is employed principally in the purchase and resale of a corporation or municipal bond issue.

A "purchase syndicate" (the term is used chiefly in distinction to a loan syndicate) may be an "underwriting syndicate" or a "subscription syndicate," or may combine the leading features of both, or even include, in addition, the features of a "loan syndicate" or a "trading syndicate," and is used chiefly in reorganizations. An instance of such combination may be found in the reorganization of the Pere Marquette Railroad, now undergoing that process. Here the "purchase syndicate," so-called, acquires (1) a large block of preference and common shares. All of these preference shares are offered for subscription to securityholders, the syndicate retaining ultimately only such of the preference shares as are not subscribed for by the securityholders, and, with the exception of a small amount of the common shares, the same is true of these. So far as the treatment of the preference and the common shares is concerned, we find here a good illustration of the principles of an underwriting syndicate. (2) The syndicate acquires a large block of non-convertible first mortgage bonds. These bonds and a small amount of common shares are not, however, offered to the securityholders for subscription, but remain in the hands of the syndicate managers, for sale by them for syndicate account, directly to the investor or for other disposition by them. This part of the transaction is, therefore, in the nature of a "subscription syndicate." (3) The syndicate also embodies, to some extent, the features of the "trading syndicate," which I shall describe a little later. The Pere Marquette syndicate is designated in the reorganization plan as a "purchase syndicate." Its title, as you will have seen, does not enlighten us as to its functions. We must read the syndicate agreement or the reorganization plan if we wish enlighten-



ment on that subject. Here, then, is another illustration of that looseness in the use of terms that I spoke of a little while ago. You will ask why then was it called a "purchase syndicate," and the answer, as I have already indicated, is to distinguish it from the "loan syndicate," which performs a separate function in that particular reorganization. To have called it an "underwriting syndicate" would have been misleading, as only a part of its function is to "underwrite" an offer of stock to the securityholders. To have called it a "subscription syndicate" would have been to mislead also, as only a part of its work consisted in the outright purchase of the first mortgage bonds; so it was called what in truth it is, a purchase syndicate; but the amount of information conveyed by that designation is not startling.

A "loan syndicate," as its name implies, is a syndicate undertaking to lend money for a fixed period of time, at fixed rates of interest, sometimes plus a commission to be paid by the borrower, and is always against collateral security, except when the borrower is a very strong corporation. At times, such a loan is to a corporation; at other times, it is to a reorganization committee or to reorganization managers, and still at other times, it is to another syndicate, be it "purchase syndicate," "subscription syndicate" or "trading syndicate," but rarely to an "underwriting syndicate" proper. Loans by a "loan syndicate" to a corporation are usually to provide it with cash until it can finance itself by a sale of securities. Occasionally the loan carries with it an option on the securities subsequently to be sold. Loans to a "purchase syndicate" or to a "subscription syndicate" are to obviate the necessity of subscribers to such syndicates having to provide all the money themselves. Loans to other

syndicates are usually margined by a payment of from 10 per cent to 25 per cent in cash and are secured by the entire assets of the borrowing syndicate. This assures additional safety to the loan syndicate and protects all the other members of the borrowing syndicate against a default on the part of any one of its own members.

"Reorganization syndicates," as the name implies, are formed to facilitate the reorganization of railroad or industrial corporations. They usually continue longer than other syndicates. They are almost invariably of the nature of an "underwriting syndicate" and frequently of that of a "subscription syndicate," also. Occasionally they are also of the nature of a "loan syndicate" or of a "trading syndicate." The Missouri Pacific Reorganization Syndicate combines in itself the characteristics of all of these. (1) It underwrites an offer of sale of new securities to the existing stockholders. (2) It offers to buy new securities to a limited amount to enable the reorganization managers to pay off non-assenting bondholders. (3) It agrees under certain conditions to loan money to the reorganization managers, to facilitate certain features of the reorganization. (4) It gives the managers power to trade in the securities of the company. Reorganization syndicates perform whatever financial services the nature of the particular reorganization requires.

A "trading syndicate," sometimes called a "pool," is usually, though not always, a speculative venture, for the purpose of advancing the price of some particular stock, either owned or to be acquired by those forming the "pool." The members of the "trading syndicate" or "pool" are, unlike the members of other syndicates, very few in number. The manager of



such a syndicate or pool usually gets as his compensation a portion of the profits merely, and no fixed commission other than the one-eighth of 1 per cent required under the New York Stock Exchange rules. Now, almost every kind of syndicate, as I have already indicated, except a "loan syndicate," has usually a provision permitting the managers to buy or rebuy after sale, and to sell and resell after purchase, a certain amount of the securities included in the syndicate operation (provided the stated maximum commitment of the syndicate be not exceeded), this for the purpose of enabling the managers to keep steady the price of the securities to be marketed. To that extent it resembles a "trading syndicate." But in such cases, the trading feature is incidental merely, for it is inserted not so much for the purpose of enabling prices to be raised as it is for the purpose of preventing declines.

There is still another kind of syndicate which has no special name, but which may be termed "promotion syndicate." This kind of syndicate was much in use fifteen to twenty years ago, during the era of combination of industrial enterprises. It facilitated the formation of many of the larger corporations existing today. Its nature was not very different from the "subscription syndicate," in that it required from its members the purchase of certain securities of the new company to be formed, but its object was neither to finance the needs of an existing company nor to facilitate a reorganization, nor yet to make a loan to a company or to another syndicate, but for the purpose of providing the cash needed to purchase a number of companies engaged in the same or in a supplementing line of business, for the purpose of uniting them into one company and for providing

that company, when formed, with sufficient working capital to get started.

A modern form of "promotion syndicate" is a syndicate formed to take over an existing firm and to transform it into a limited liability company, or else to take over an existing limited liability company, the stock of which is held by a few stockholders, and after recapitalizing it, to create a market for its securities, with investors. This usually involves the creation of one, and occasionally, but rarely, several kinds of preferred shares of a volume small enough in proportion to assets and earnings to make them a safe investment, and of common shares. A large part of the latter class is frequently retained by those that originally built up the business and that expect to continue to conduct it, the rest going to the bankers, and to the syndicate which, through its managers, place them with investors that are speculatively inclined.

I have this afternoon frequently spoken of the syndicate managers without defining the meaning of the term. A definition seems hardly necessary, as the term is self-explanatory. The firm or firms (occasionally, but very rarely, the manager is an individual; still more rarely are there two or three individual managers) constituting the syndicate managers, undertake to manage the syndicate, and are given full powers by the terms of the syndicate agreement (which is sometimes a formal agreement and at other times in the nature of a letter) to do all acts in their judgment necessary or desirable to make the syndicate a success. They receive a compensation for their services, which is either a fixed commission or a percentage of the profits, and sometimes both. Occasionally the syndicate managers receive no direct



compensation from the syndicate, having made a profit in the turning over to the syndicate of the securities acquired. The best practice today, and one that is being more and more adopted, is the full disclosure to syndicate members, of the profit and commission made or to be made by the syndicate managers.

It is the custom for syndicate managers to be interested as participants in their own syndicate. As such syndicate participants, they are entitled to their share of profit, and must assume their share of loss. Their status in this and in every other respect is the same as that of other participants of the syndicate. The limitations on the syndicate managers consist usually of the following:

(1) that each participant shall be liable only for his proportion of the obligations to be incurred by the syndicate, and for his share of the losses.

(2) that the obligations to be incurred shall not exceed a given sum.

(3) that the syndicate shall be so conducted that each subscriber, in discharging his share of the syndicate obligation, shall ultimately receive his share of the syndicate assets.

(4) that the life of the syndicate shall be for a stated period of time.

The syndicate agreement or syndicate letter naturally states the nature of the securities to be acquired, or, in the case of a "loan syndicate," held as collateral, the terms, such as purchase price, rate of interest, and generally such information as is necessary to enable the prospective participant to judge whether he desires to join in the venture; and this is done quite as much to protect the syndicate managers as it is to enable the participant to judge of the merits

of the enterprise. Success in the formation of a syndicate depends to a great extent on the reputation of the syndicate managers for good judgment, fair dealing and success in conducting previous syndicates. In fact, syndicate operations from start to finish are based on faith in character, ability and experience. No syndicate member ever asks for an accounting from the managers, and none is ever given unasked by the managers to the syndicate participants. The letter announcing the distribution of profits or the apportionment of losses sometimes states that the syndicate accounts are on file for examination by any syndicate member, and such accounts are carefully prepared and kept among the syndicate managers' records, but for any syndicate member to avail himself of the offer contained in the letter of the managers, would be regarded by the latter as an intentional affront and business relations between the managers and the inquisitive syndicate member would terminate as soon as the examination of the accounts was completed. If a firm declines the offer of a participation in a syndicate financed by another firm, the declination is usually remembered, but among sensible people not treasured up as a grievance against the declining firm, which may have good reasons of its own, not reflecting upon the character of the proposed business, for declining; but if several such declinations follow one another, without a volunteered satisfactory explanation, the firm declining participations will be dropped from the other firm's syndicate list. Some houses are so sensitive or aggressive (call it what you like) that one declination is regarded by them as sufficient for dropping a firm from their lists. Most people, however, look upon such a course as unnecessary, and as not in good taste. On the whole, I know of no financial transactions that are conducted so much upon faith and trust and enlightened self-interest as are syndicate operations.



A term frequently used in connection with syndicates is "withdrawal." The right of withdrawal accorded to syndicate participants is the right on their part to withdraw their share of syndicate securities from sale by the syndicate managers, upon payment of their proportion of syndicate expenses and syndicate managers' commission, and upon their agreement not to sell or offer such securities for sale, during the life of the syndicate. The object of the participants in exercising the right of "withdrawal" is either to hold the securities for permanent investment or else to hold them for higher prices, in the belief that on the expiration of the syndicate, or soon thereafter, higher prices will prevail than those at which the managers are likely to market the securities. Some syndicate agreements contain provisions for "withdrawals"; others, however, do not. Of late the tendency has been not to permit withdrawals as tending to interfere with sales of the syndicate holdings by the managers. This compels syndicate members desiring to hold securities forming the subject of syndicate control, whether for investment or for higher prices, to purchase such securities from the syndicate in the same manner as an outsider would have to do.

Many financial transactions that have syndicates back of them seem at first glance perhaps not to require this protection. I refer more particularly to "underwriting syndicates," using the term in its strict sense, but to those of wide experience and good memories, the cost of securing an underwriting in such cases rarely seems money wasted; for in the first place

it is grounded deep down in human nature that most people will follow only when others lead, and that the confidence inspired by a syndicate's willingness to undertake the risk, which in turn is largely inspired by the syndicate managers' willingness to head the syndicate, is what induces these shareholders, or others to whom the securities are finally offered for sale, to subscribe for them. Another reason for securing an underwriting, in the case of financial transactions that do not seem to require it, is that financial skies sometimes change quite suddenly, and few there are that are able far in advance to discern the face of the sky or the signs of the times.

Let me give you a modern instance: Some few years ago when Pennsylvania Railroad stock sold in the market at a price far above par, the company required additional capital, and, to provide it, offered as "rights" a not excessive amount of its stock for subscription to its shareholders at about twenty-five per cent below its market value. No underwriting syndicate was formed, as the board of directors believed the expense to be unnecessary. Financial conditions, however, became unfavorable, and shareholders seemed to waver about subscribing to the stock. The stock declined to about the offering price, and to all appearances the issue was going to be a flat failure. At the last moment, the company caused a syndicate to be formed by leading bankers, which for a commission, agreed to take at the offered price, all stock not subscribed for by the shareholders. Strangely enough, this caused a rapid change of heart on the part of many shareholders. If good enough for the syndicate, so they thought, the stock was good enough for them at the price. The syndicate was compelled to take only a part of the stock, and before



long this part was disposed of at a profit, and the syndicate closed with satisfaction to its members, its managers, the company and the shareholders, thus proving that money paid to bankers is not always wholly wasted.

The profits of syndicates vary so much that it is next to impossible to give you any very accurate information in regard to these. I may say, however, that the shorter the syndicate life, the smaller usually are the commissions and the lower the rate of interest, if the syndicate be a loan syndicate. "Underwriting syndicates," using the term in its strict sense, usually receive smaller commissions than do any other kinds of syndicates except loan syndicates, which latter frequently lend, depending on the time as well as on the times, at varying rates of interest from 4 per cent to 6 per cent, without commission, except on such amounts as may be held at the disposal of the borrower and not availed of by him. On such latter amounts a small commission (a fraction of 1 per cent) is usually exacted.

It is natural that an "underwriting syndicate," whose sole obligation is to take such securities as may not be taken by those to whom, in the first instance, they are offered at what is regarded as attractive prices, should be content with a smaller commission than would a "subscription or purchase syndicate" that binds itself absolutely for large fixed amounts, over a longer period of time.

The commission paid to "underwriting syndicates," again using the term in its strict sense, varies from 1 per cent to 4 per cent. Rarely is the commission as low as the minimum or as high as the maximum here given. I should say that 1½ to 3 per cent would more nearly express the current figure. Sometimes

a part of the stipulated commission is contingent. In the case of several recent syndicates of which I have knowledge, the commission agreed upon amounted to 2 to 3 per cent, fixed on the maximum amount of the commitment, and 2 per cent additional on such amount of securities ultimately taken over by the syndicate, as was not taken by the shareholders on account of their "rights."

The commission paid to "subscription syndicates" is usually in the form of profits, that is, the difference between the price at which the securities are bought and the price at which they are sold. Such net profits vary, depending on the judgment used in fixing the purchase price, and on the face of the financial sky. Sometimes profits are as low as a small fraction of 1 per cent (as was the case with the Interborough Rapid Transit Bond Syndicate that lasted four and a half years, and, because of peculiar conditions, returned to the participants a profit of only $\frac{5}{8}$ per cent) and sometimes as high as 4 per cent, or even more, but the latter rate is exceptional.

"Reorganization syndicate" commissions or profits run between 2 and 4 per cent, but occasionally exceed the latter figure—not often, however, though in one case the profit amounted to as much as 8 per cent.

"Promotion syndicates," when profitable, yield larger profits than do any other kind of syndicate ventures. The profits of these vary from 5 to 20 per cent, and occasionally, though rarely, even more. An average of from 5 to 10 per cent is regarded as very satisfactory. You will see that, compared with the risk run, the commissions and profits of all syndicates, other perhaps than promotion syndicates, seem small. Losses are not infrequent, and even where there are no losses, the length of time during which



money is occasionally tied up may cause a comparative loss, insofar as it prevents participants from using their money elsewhere to greater advantage.

The commissions and profits of syndicate managers vary greatly, running from as low as one-fourth of 1 per cent, which is rare, to as high as 2 per cent. Commissions in excess of 2 per cent are likewise rare. Sometimes the managers retain an interest in the syndicate profits merely, without receiving any commission, at other times this participation in profits is in addition to a fixed commission. The percentage of such participation in syndicate profits varies from 10 per cent to 25 per cent, but this sounds much greater than in reality it is, for even 25 per cent of say a 4 per cent syndicate profit, is only 1 per cent on the total syndicate commitment, and it must not be forgotten that the syndicate manager earns his profit by the sweat of his brow, of his brain and of his capital, while the syndicate member earns his by the sweat of his capital merely. In a "promotion syndicate," where syndicate profits are greater, the syndicate managers' profits are greater also, but these are usually represented by bonus shares. The ~~recapitulation~~ recapitalization of an existing company or the transformation of a firm into a limited liability company effected by a promotion syndicate, usually results in the new company's issuing, as I have already said, preference shares and common shares, the latter nowadays being frequently without par value; that is, each share representing an aliquot part of the company's net assets and net earnings, after providing for the claims of creditors and of the holders of preference shares. These bonus shares frequently have at the beginning only a low market value, although occasionally, especially in boom times, they sell at the outset at quite a substan-

tial price. But in the course of time, such shares, what with good management and good times, not infrequently advance to very high prices, thus making large profits for the syndicate and its managers, as well as for those purchasing the shares at the outset.

I have referred to shares without par value. I do not intend to take up your time by any extended observations concerning them; you are probably entirely familiar with them and their uses; but I do want to emphasize their special use in enabling an equitable apportionment of prospective profit between the vendor, the promoter, the syndicate, the syndicate manager and those undertaking the conduct of the enterprise, without, at the same time, bringing up vexatious questions as to whether shares issued for these purposes are full paid and whether or not good will has been overvalued. I shall be glad later, if anyone is interested in this particular subject, to go further into it, or into any other matters touched upon by me this afternoon, but I fear that when I have concluded my address, you will have had quite enough.

A word of explanation in regard to "public issues" and "public subscriptions." The method of selling bonds and high grade investments in days gone by, used to be almost exclusively by "public issue" or "subscription." The syndicate managers would advertise the securities to be sold, giving a condensed explanation of their merits, and would then conclude the advertisement by saying that the "subscription books" would open on a certain day and remain open for two, three or four days, at the end of which time allotments would be made. A small payment down, varying from 2 to 5 per cent of the amount applied for, was required. Usually public issues would be



oversubscribed. While offer by "public issues" or "subscription" is still occasionally followed, no syndicate manager any longer places reliance of success upon such offer. The placing of investment securities with investors is now done almost exclusively by so-called "bond houses" that make a specialty of this sort of business, and by the bond departments of such great institutions as the Guaranty Trust Company and the National City Bank. When the syndicated securities for sale have practically all been disposed of through such agencies, the present custom is to insert an advertisement, signed by the syndicate managers as "issuing house," but, instead of concluding such advertisement, as formerly, with a statement regarding the opening and closing of the subscription books, a short sentence appears instead, to the effect that the advertisement appears merely for the sake of record, as all of the securities have previously been disposed of. The method by formal opening and closing of subscription books is still at times made use of, but much less frequently than formerly, and its success is about equally rare, except where such advance work has been done by the syndicate managers through bond houses and bond departments of institutions.

The American method of conducting financial operations through syndicates I have tried to make clear to you this afternoon. The English method is somewhat different. In England the syndicate manager, as we know him, does not exist, but his place is taken by the "issuing house" or the "emission house," as it is termed. There the issuing house on its own behalf contracts to purchase an issue of securities, but instead of forming a syndicate to share the risk, the house proceeds through brokers to secure underwriters, who undertake to subscribe for such of

the securities as are not taken by the public on the public issue. These underwriters for their services receive from the issuing house a commission of from 1 per cent to 2½ per cent, and the brokers for their services a commission of ¼ per cent to ½ per cent. The expenses of emission, which in America are borne by the syndicate, in England are assumed by the issuing house. The underwriters are ignorant of the price paid by the issuing house for the securities that it offers for public subscription. The underwriters there judge first whether the issue "will go" by estimating whether the price is likely to be attractive and whether the issuing house has a reputation for success; second, whether the syndicate commission is commensurate with the risk. The underwriters see the prospectus in advance of publication, but they are more likely to judge by the name of the issuing house than by the contents of the prospectus. A prudent issuing house usually has the issue underwritten before, or simultaneously with, its purchase of the securities. As soon as feasible the prospectus is published and subscriptions based thereon are received by the issuing house. If the public subscribes for the entire amount, the underwriters are not called on to perform any further services, their services having consisted in standing in the breach. They have received their commission, and the transaction, so far as they are concerned, terminates. In case the public issue is a failure and none of the securities are subscribed for, the underwriters must take up the full amount of their undertaking. In case only a part of the securities are sold to the public, the remainder is apportioned among the underwriters in accordance with the amount of their underwriting. In all cases the underwriters make formal application for the



amount of securities underwritten by them, on a special application form, differing from that used by the public. The only difference between their subscriptions and those of the public is, that their subscriptions go into effect only if and to the extent that the public does not subscribe for the entire amount of securities offered. The underwriters pay the same price as that paid by the public; however, they also receive their commission. They receive their allotments at about the same time as do the other subscribers. They are just as free as the other subscribers to sell in the market the securities subscribed for by them. Save in exceptional cases, there is no such syndicating or tying up of the securities allotted to them, as in the case of an American syndicate. No syndicate period, therefore, exists for them. The commitment on their part is of extremely short duration, as the underwriting precedes the issue by only a very few days or at most weeks. The longer the period between the underwriting and the public issue, the larger is the commission. The great advantage of their system over the American system is that the underwriters do not tie themselves up for any considerable length of time. The American syndicate, however, has this advantage—that, if the securities, when offered for subscription to the public, either through the "issuing house" directly or through bond houses or the bond departments of institutions, are not at once disposed of, an obligation rests upon the syndicate managers to make an effort, during the remainder of the life of the syndicate, to market the syndicate securities through other channels. Sometimes this is not feasible, and on the expiration of the stated syndicate period, and earlier if the managers so decide, the unsold securities are handed over to the

syndicate members. Rarely, however, do syndicate managers avail themselves of the right to dissolve the syndicate before its expiration by flux of time, and never until they become convinced that they cannot gradually dispose of the securities left unsold. The responsibility resting upon the American syndicate manager is greater than that which rests upon the English issuing house. In England the underwriters are at liberty to dispose of securities not subscribed for by the public, hence, a free market usually exists immediately after the public issue. In the case of the American syndicate, in so far as securities are nursed over a period of months, with power to the managers to act for account of the syndicate, in selling and rebuying and reselling, it frequently results that the market for the particular security during the life of the syndicate is an artificial one and is generally recognized to be so. The tendency in America is constantly toward shorter and shorter syndicate periods, and the days of syndicates for unlimited or long periods of time are about past. In this respect the American method of conducting financial operations is approaching more nearly to the English method. On the other hand, just before the war, general conditions led to the failure of many issues under the English system, resulting in lower prices after emission. In order to correct this the custom developed of interesting large investors, such as insurance companies and trust companies, as underwriters, as these investors would hold the securities that they were compelled to take up and, being investors, would not throw them upon the market. This course only intensified the trouble, as these investors, expecting to take up some of the securities underwritten, refrained from subscribing on the public issue. It is



thought by some that England may have to adopt American syndicate methods. On the whole, each method is probably best adapted to the financial habits and traditions of the respective countries.

In conclusion, I wish to repeat that, although suspected by those unfamiliar with their nature and the methods of their operations, of being fraught with danger to the public interest, syndicates are quite harmless and extremely useful. Their purposes are simple, their conduct is according to the best practices, and their profits, when there are any, are not inordinate, and, moreover, their life is "of few days," and, I am sorry to say, not infrequently "full of trouble."

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